No. 9242

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

West Coast Life Insurance Company (a corporation), Pacific National Bank of San Francisco (a national banking association), et al.,

Appellants,

vs.

Merced Irrigation District,

Appellee.

MEMORANDUM ON GENERAL FINDING OF FAIRNESS and OUTLINE OF CLOSING ARGUMENT OF EVAN HAYNES, ON BEHALF OF APPELLANTS.

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MEMORANDUM ON GENERAL FINDING OF FAIRNESS

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OUTLINE OF CLOSING ARGUMENT OF EVAN HAYNES, ON BEHALF OF APPELLANTS.

INTRODUCTION.

For the sake of brevity and clearness, repetitious matter is omitted from the oral argument, confused statements are clarified, and questions from the Bench are omitted wherever the answer is self-explanatory.

Following the oral argument appears a memorandum concerning general findings, which the Court requested us to file.

If the Court please, appellants are not here demanding their pound of flesh on points of law. We believe

our points of law are good; but that is not why we are here. We believe the record demonstrates the soundness of our view that this plan—and I choose my words—is an outrage; and for that reason it is necessary that I discuss the facts at some length.

The amount the district can reasonably pay should be determined on the basis of its average income, not the lowest fluctuations thereof.

On the pyramiding point, much has been made by Mr. Downey, and other counsel in the various cases, of the proposition that the district is required to levy one-thirtieth, let us say, or one-fortieth, of the total bond issue every year, plus interest, plus the amount of the district's past defaults, and that when you get a bad year or two, or three, the result is an impossible situation.

In fact there is no such hazard, for this reason: It is true that under the California law a sufficient levy must be made each year to pay the amount coming due that year plus any amount in default; and thus the amount pyramids if defaults accumulate.

This, however, is not necessary. Thus, the first refunding plan avoided this difficulty. This district's income does fluctuate widely, because of fluctuation in power revenue, and also in farm prices. But a fluctuating income does not mean an inadequate income, and I submit as a proposition of law that if the district's income, over a reasonable period for a bond issue to mature, is sufficient to pay a certain amount, the fact that in some years its income will be low and in others high, is irrelevant. It is a common thing nowadays, as the first refunding plan proposed, in the case of debtors with widely fluctuating incomes, for bonds to be issued with maturity at the end of the total term, contemplating that the

debtor will levy high assessments when prosperous and low assessments when income is low; taking up bonds (which are callable) when they have the money, and not being bound to levy large assessments when they haven't got the money.

The first refunding plan was approved by the California District Securities Commission as legal and proper, and provided for such bonds.

It is simply a fact, therefore, that this district can, without any difficulty, devise a plan which will give the bondholders the benefit of prosperous years and will not put the district in distress in bad years.

The question of law is presented therefore, whether a plan is fair which ignores the possibility of giving the bondholders the benefit of the average of fluctuating income.

Secondly, I submit that it is the duty of the State. to do just that. This Bankruptcy Statute is a curious thing. It is, as the Court has pointed out, something in the nature of a treaty. The Supreme Court, in the *Bekins* case, says the states can contract with the United States for the surrender of some of their sovereign powers. This statute, as the Court speaks of it, is a "co-operative" venture. The Court uses that word three times in its opinion. It says Congress must not, and does not purport to, interfere with the exercise of sovereign powers.

Now, if that is true, I submit that the State's part of this co-operative venture is to provide machinery for compliance with the rules laid down in the law and the cases as to what is a fair plan. The State, I submit, is not entitled to come into Court and say, "We want a plan approved, scaling down these debts 50 per cent and also (as against the objecting bondholders) cancellation of six years of interest", unless such a plan is fair within the meaning of that word in the statute.

The district argues that the bondholders cannot be paid what the land will reasonably yield, because if a two or three, or four year period comes along when crops are bad and the landowners haven't much money, the statute compels the district to go right ahead levying the annual bond service, interest and amortization, plus all amounts in default.

We have already shown that means for avoiding this difficulty are available under the existing State law. We now submit that even if this were not true, it is incumbent on the States to provide procedural means whereby the federal requirement of fairness can be complied with.

As already shown, there would be no difficulty in having the district devise a plan, under the present statute, whereby the bondholders could be given what I submit they are entitled to, the benefit of what the lands are reasonably able to pay on the average.

Now, there are a few points, which Mr. Downey made, that I must touch upon. He seemed to say this was our plan, the bondholders' plan. That is not true. The bondholders had nothing to do with the negotiations with the RFC. In a letter submitting this plan to the bondholders, the bondholders' committee said:

> While the committee feels that the figure offered pursuant to the Reconstruction Finance Corporation loan is unduly low, it is, however, important that the committee be advised of the wishes of the bondholders" (R. 498).

The committee stated that it would depend on their individual conditions whether they could stand to wait or not (R. 498).

Counsel made a great deal of a long letter, reading from it for fifteen minutes, from the bondholders' committee to the bondholders, submitting the first refunding plan. That letter, I assume, is not put forward as evi-

dence of the facts recited by the bondholders' committee, except, possibly, as an admission by some few of these objectors who were members of the committee that signed the letter. In any event, the opinion expressed in the letter is that in view of the Benedict Report **the district can pay the full principal amount of its debt,** provided it is given time within which to catch up on the depression.

Mr. Downey disputes our statement that this district's bonds were quoted at 56 eight months before the RFC loan. In fact, however, they were. On February 5, 1935, a bond house in San Francisco bid on Merced Union High School District bonds due July 1, 1936, at a price to yield 1.10%, and also bid 56 flat for Merced Irrigation District bonds (R. 889).

Power revenue.

As to power revenue, Mr. Downey seemed to imply that the experience of the operation of the district since 1926 shows that one does not get the revenue from the run-off that one would expect to get.

The fact is that the studies, which are quoted and cited in our briefs at length, took account very carefully of the actual experience of the district as a basis for the computations of what the power revenue would have been in the many years before the building of the dam, for which the run-off is known. They take the run-off month by month, and show what the revenue would have been on the basis of what it has been during the years of actual operation; and there is no margin of error involved. No attempt was made by appellee to upset those computations. A mere reading of them—they are both by eminent authorities from two independent sources—is a demonstration of that.

Mr. Downey is really asking the Court to say that, since, during the period of operation since 1926, which included the nine lowest consecutive years in history (R. 535), the

revenue has been less than it would have been in the experience of the run-off which is available from the records, therefore, we should take this very dry period as the average run-off. On that theory the Pacific Gas & Electric Company would only be entitled to a return on about half of the value of its power plants.

Now, let us take their estimate—not because it is defensible, but because the results are astonishing, even though we do take it. It is significant that this district's plan, which says they can pay $8,500,000, had at the time of trial become a plan to pay $7,000,000, not $8,500,000. This because in the interim (i.e., in the three years between the submission of the plan and this proceeding), they have accumulated over $1,500,000; and the total debt which they will have, if the plan is approved, will be the amount of the debt less the cash on hand.

On its own estimate of power revenue, based on these seven years, the district will receive, from the operation of the power plant, over and above operating expense and depreciation, $400,618 a year, an amount greater than that necessary to amortize the actual bond issue which they propose. The amount that it will take to amortize that debt of $7,000,000 in thirty years is $9895 **less than** the net return from the sale of power alone, i.e., after deduction of the total cost of operation, and depreciation; so that what this district says is, that this plan is fair, notwithstanding the fact that in thirty years, it will be able to pay the entire amount which it offers out of this power plant that was built for it with the bondholders' money; and during that thirty years will have $9900 odd left over to use toward general operating expenses. At the end of that thirty years, having accumulated a depreciation fund, it will, in effect, have a new power plant.

Under our computation of power revenue, which is dealt with adequately in the briefs, the surplus of the power revenue, after deduction of operating expenses and depre-

ciation, and after meeting payments on the proposed bonds, will average $64,956 a year. So, if the plan is adopted, this district will continue to operate for the next thirty years **without any expense whatsoever toward payment of its debts,** and, far from having such expenses will, taking their theory and our theory, have somewhere between $9000 and $64,000 **net income** after paying the installments on its debts, to apply toward general operating expenses of the irrigation system.

And, as I say, after thirty years they will operate the district **without any assessments at all** on our theory of operating expenses, and on their own theory there will be $100,000 a year to collect from the land, or an average of about 60 cents per acre per year that the water will cost the landowners thereafter.

Ability to pay.

Now, as to the ability of the lands to pay, the district relies almost entirely on the Benedict Report. There are two principal things to be said about that report. It dealt, for the period 1926-1928, only with a few large ranches. For the period from 1929 to 1931 it dealt with 150 out of the 2200 ranches in the district, selected by lot. It ends with the year 1931, i.e., in the depths of the depression, seven years before this action was commenced. It therefore sheds very little light on ability to pay now.

Moreover, the Benedict report repeatedly says what is obvious on the face of it, that the district was then in its early stages of development. The report starts with the year that they started to fill up the reservoir. It says repeatedly that the district was in its development stages. There are very few conclusions in it, I might say, but here is one of them:

> "Some question may be raised as"—and this is speaking as of 1931—"some question may be raised as to whether the district ever has reached a stage of earning ability such as it could meet out of production

> income all its forms of cost and carry its bonded indebtedness" (Ex. 35, pp. 19-20).

Later on, the report concedes that when the depression arrived the district had not readjusted itself to the changed condition arising from the construction of the irrigation dam system, which was obvious (Ex. 35, p. 70).

That is all the evidence Mr. Downey mentioned in support of his argument concerning ability to pay.

The most striking fact concerning the Benedict Report is that it was the basis upon which the conclusion was reached by the district and the bondholders that the first refunding plan was feasible, namely, the plan whereby the district asked that it be allowed simply to reduce interest for seven years. That is the conclusion that the district and the bondholders' committee drew from the report. Its other defects are rather hard to state orally, and I will not state them. They are detailed in our briefs.

However, let me say this, that Mr. Downey made much of the proposition that 80,000 acres of the lands in the district are in "Class III", as classified in this report. In fact, Class III lands are described in the report as follows: Poor irrigated farming **for crops other than rice and grain** or forage for pasture; fair to good rice and grain land; pasture from fair to excellent; dry farming grain land on areas too undulating for practical irrigation; large acreage dairy farms, where, perhaps, 25 per cent of the land will raise alfalfa, the balance to be used for natural pasture (Ex. 37, p. 130).

There is no attempt to segregate and give the amounts of each of these varieties of land, so that all we know is that these 80,000 acres contain somewhere between one and 99 per cent of fair to good rice land, and good alfalfa land; the report doesn't say how much.

Judicially, therefore, not to say practically, the report does not contain any evidence that any substantial part

of the lands in the district are not good lands. There is adequate evidence that for the most part they are good lands.

I should say something of one other item of evidence, namely, certain reports of the District Securities Commission. The appellee does not rely on it much, apparently, because it is mentioned only in a footnote in their brief; and Mr. Downey didn't mention it in his argument at all; but if the Court should read it after reading the footnote, it appears to have some plausibility, and I must mention it.

These are reports by the District Securities Commission, the Commission which, under Section 11 of the District Securities Commission Act, approves the levy by the district of low assessments in emergency periods. The section is set out in the appendix to our brief. It requires that so long as a district is levying low assessments under Section 11, it must annually make an estimate as to how much the lands can reasonably pay in assessments during the coming year; and requires that estimate to be approved by the Commission.

These reports show on their face that they were made on data supplied by the district, and that they are merely estimates of production for the coming year. Two of the reports are in the record, one for 1933 and one for 1936. The one for 1933 puts its estimate of production on the basis of the Cone report, which, in turn, is an estimate based on data supplied by employees of the district. Prices are estimated, and the report says this is a "hazardous occupation". (R. 687). Costs of production are estimated on the basis of the Benedict report, and those estimates are analyzed in great length in our brief, and shown to be undependable.

Moreover, these reports did not pretend to be for typical years in any sense. Indeed the 1936 report states that

three very important crops in the district, namely, raisins, peaches and figs, respectively were expected to be only 40, 60 and 75 per cent of normal. On the basis of that kind of data the commission accepted the district's estimate that in the coming year the income would not be sufficient to pay more than $3 per $100, with a 15 per cent delinquency. In the last two years, the delinquency was about half of 15 per cent, on the basis of their levy approved by the report (R. 668).

The yields set out as probable for the different crops in that report are, if I may say so, fantastic. Just as an example, for almonds it says the average production is 200 pounds per acre. Maybe it was that year, but the Benedict report itself shows an average crop of almonds as 800 pounds per acre, namely, 400% of the estimate in the report; and so on for deciduous fruits, raisins, alfalfa, and for other crops. (See R. 100-102, Ex. OO, p. 145).

Actually these reports amount to this: The district says, "We need $3 per $100, to operate next year. We submit the following figures as showing that is all the lands will be able to pay from earnings".

And the District Securities Commission says, "That is all right".

I have already discussed, and I will not repeat it, the testimony of Mr. Momberg, the petitioner's witness. He testified to data showing that the lands owned by the Bank of America earned about $2.50 an acre right through the depression and over a seven year period, after paying current taxes of all kinds, and actual operating expenses.[1]

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1. We set out the following table to substantiate our assertion.

Mr. Momberg, who manages these fifty ranches for California Lands, Inc. (containing a total of 3,688 acres, R. 472), testified concerning their operation from 1933 to 1937. It is true that his first testimony on direct examination was to the effect that the

Actual experience shows ability to pay.

Now, on the other hand, is there any affirmative evidence of ability to pay?

The record contains the assessments actually paid to the district year by year, since its organization, to date. These figures show that during the entire eighteen years that it has operated, including the early formative years, some very good years that followed, and the long and hard years of the depression, **the landowners have actually paid in assessments an average of $700,421 a year**

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ranches lost money on the whole. On cross-examination, however, it developed that this was not the fact.

He divided the fifty ranches into three groups of 12, 4 and 34 ranches, respectively, as appears in the table.

All of the figures in the table are the corrected figures finally testified to by Mr. Momberg, and appear in the Record at pages 481-484.

All Figures in the Table Are From R. 481-4.		12 Ranches, 572 Acres	4 Ranches, 867 Acres	34 Ranches, 2249 Acres	Total Net Profit
1933	Gross Income	$7,596	$18,368	$11,317	
	Expenses	734	13,911	888	
	Taxes	2,874	3,501	7,375	
	Net Profit	3,988	955	3,053	$7,996
1934	Gross Income	6,266	36,173	12,346	
	Expenses	3,045	22,413	1,912	
	Taxes	1,576	2,020	7,660	
	Net Profit	1,644	11,640	2,772	16,056
1935	Gross Income	6,661	25,270	11,387	
	Expenses	1,943	24,229	2,060	
	Taxes	2,002	3,460	20,350	
	Net Profit	2,715*	—2,419*	—11,022*	—10,726*
1936	Gross Income	13,435	22,470	14,602	
	Expenses	4,228	21,567	2,069	
	Taxes	2,329	3,011	8,949	
	Net Profit	6,877	—2,108	3,583	8,352
1937	Gross Income	13,775	33,958	17,753	
	Expenses	3,699	18,762	2,781	
	Taxes	2,285	2,976	7,437	
	Net Income	7,790	12,220	5,534	25,544
				Total Net Profit	$47,222

*The apparent loss for the year 1935 was in fact a net profit of $1,100, or more, instead of a net loss of $10,726. In that year California Lands,

(R. 705, 667). **This equals full payment of assessments of $6.60 per $100 on present assessed value.**

Now, that is not an estimate, it is a fact. Much of it was paid after it became due, but it was paid. That is to say, the actual experience of this district throughout the 18 years of its history has been that the landowners are willing to pay to the treasurer of the district on the average enough to amortize at 4% in thirty-three years over $15,400,000, i.e., over $8,400,000 more than the bond issue here proposed. (All such figures are based on ordinary bond amortization tables, showing what payments will amortize a given amount at a given rate of interest in a given number of years.)

The plan here proposed is a 4% refunding bond issue to be retired in 1975, i.e., in 35 years from the present.

Inc., paid up, in a lump sum, taxes levied in 1932 which had been allowed to go delinquent (R. 488). The district had been earlier threatened with a tax strike, by mortgagees and others (Ex. 00, p. 64, R. 420), and, although California Lands, Inc., apparently did not join in the threats, it apparently did join in the strike.

From the foregoing table, the following results appear:

(1) For the five-year period concerning which Mr. Momberg testified, the net income from the lands operated by him averaged (after payment of actual operating expenses and all taxes) more than $2.50 per acre per year. This notwithstanding that a considerable part of the period was in the period of very low agricultural prices. See the price table (R. 734). Agricultural prices started rising in 1933 from the all-time low of 1932, and have risen steadily ever since.

(2) The taxes over this period averaged over $3.50 per acre per year.

(3) For the years 1936 and 1937 (the only two years in which the taxes paid were the current taxes and no others (R. 486), the average net income per acre per year for the lands operated by Mr. Momberg was $4.59 per acre. Farming operations by agencies such as California Lands, Inc. are admittedly inefficient (Benedict Report, Ex. 35, p. 64).

California Lands, Inc. has in recent years sold 67 ranches (other than those dealt with in Mr. Momberg's testimony and in the foregoing table), most of the sales having taken place since 1935 (R. 489).

The foregoing figures are based on average gross power revenue of $500,000 per year, and operating expenses of $400,000 per year. The district contends that its gross power revenue will average only $445,000 and that its operating expenses are $500,000 per year.

Power revenue.

It cannot reasonably be contended that the district's revenue from power will average less than $500,000 per year.

1. Two careful studies by recognized authorities (R. 890-948, 524-38) were made. One shows that the run-off of the Merced River from 1902 to 1938, both inclusive, gives an average revenue under the district's present power sale contract (which runs until 1964), of $511,651 per year (R. 937). The other study, which carried the computation back to 1871 shows average revenue of $534,000 per year (R. 534).

2. The district itself reported to the RFC that its future power revenue would average between $500,000 and $621,000 per year (Ex. OO, p. 104).

3. A competent firm of engineers employed by the district itself gave $500,000 per year as a conservative average (Ex. OO, p. 105).

4. Figures undoubtedly supplied by the district itself to the District Securities Commission, estimated in 1936 that the power revenue for 1937 would be $500,000 (R. 728); and estimated in 1937 that the power revenue for 1938 would be $500,000 (R. 783). The amounts actually received were more than $500,000 (R. 937).

The only evidence the other way consists of the fact that during the period 1926-38, which includes the lowest consecutive nine years of run-off since 1871 (1926-34, R. 937, 535), the average power revenue was $445,000.

It is plain, we submit, that in determining probable ability to pay, the district's power revenue cannot fairly be taken as less than an average of $500,000 per year.

Operating expenses.

The only testimony concerning operating expenses is that of the secretary of the district, who testified in the former bankruptcy proceeding that operating expenses would amount to a total of $400,000, excluding payments on certain drainage bonds now fully paid, and payments on Crocker-Huffman contracts which will be fully paid next year (Ex. OO, p. 63; R. 694-5). In this proceeding he raised this to $500,000, explaining the difference by additional cost of proposed capital improvements of $30,000 per year, and some increase in labor costs (R. 515). Apparently this figure includes drainage bond payments and Crocker-Huffman payments, amounting to about $50,000 per year (R. 874, 883), which will cease entirely next year (R. 694-5).

This testimony is not directly contradicted, for appellants have no means of doing so; but it is contradicted by the undeniable fact that the district's actual operating expenses averaged only $401,134.43 for the last three years shown in the record (our Reply Br., p. 43), notwithstanding the fact that during these years the district had a large surplus of cash on hand, and had no reason, therefore, to defer proper expenditures.

Moreover, the secretary's estimate of operating expenses includes $125,000 per year for capital improvements, which we submit cannot be considered in determining the ability of the district to pay its debts.

The district's own estimated operating expenses for 1938, reported to the RFC, were less than $425,000 after eliminating payments on drainage district bonds which the district took over and which are now all paid, payments on Crocker-Huffman contracts which will all be

paid off next year, and refinancing expenses (R. 774, 783, 694-5).

Even if we take operating expenses as amounting to the district's indefensible figure of $500,000 per year, the total average revenue from assessments during the entire 18 years of the district's existence, plus average power revenue of $500,000, would pay off over $13,000,000 in 33 years at 4%, i.e., $6,000,000 more than the district proposes to pay in 35 years at 4%.

And even if we go further and accept the district's contentions concerning power, and assume that in fact gross power revenue in the future will be no more than it has been during the dry period of actual operation, i.e., since 1926 ($445,000; R. 407), and that operating expenses will in fact be $500,000 per year, even so, the average assessments actually paid in the 18 years of the district's existence, plus power revenue, less operating expenses, will give a net income sufficient to pay off a debt of over $11,800,000 in 33 years at 4%, i.e., $4,800,000 more than the plan proposes.

If we take the last seven years given in the record (1931-37), starting with, and including the whole of, the great depression, we find that the landowners actually paid in assessments during those seven years an average of $517,850 per year (R. 829, 837, 846, 853, 863, 873, 881).

Taking operating expenses as $400,000 per year, this amount of assessments, plus average power revenue of $500,000 per year, will pay off over $12,100,000 at 4% in 33 years, i.e., over $5,100,000 more than the plan proposes to pay.

Even taking the district's claim as to operating expenses of $500,000 per year, the result for these seven years would pay off $10,300,000 in 33 years at 4%, i.e., $3,300,000 more than they offer, the difference to the objecting bondholders being over $300,000.

And these seven years were far below normal in farm income. Farm prices during this seven-year period (although they have increased steadily every year since 1931 (R. 734)), were so unprecedentedly low in 1931, 1932 and 1933 as to make the average for the seven years only 86% of the period 1909-14, taken by the federal authorities as normal (R. 733-4).

Moreover, the district has not even pretended to levy anything for bond service during 5½ of those seven years, the rate being from $3.00 per $100 down to $1.00 per $100 of assessed value (R. 667); so that in spite of itself, the district's income from assessments and normal power revenue has, during this period, far exceeded what its plan proposes as fair.

Our brief contains a detailed statement of the district's experience in the last three years (showing actual income sufficient to pay many millions more than it offers), and I shall not take time to restate it now (Reply Br., pp. 41-47).

In the year 1932, when agricultural prices fell to their lowest point (44% of the 1909-14 average, R. 734), and when the district levied the highest rate in its history, resulting in a 62% delinquency, the landowners actually paid in assessments $578,110.38 (R. 837); enough, with normal power revenue of $500,000 and expenses of $400,000, to amortize over $13,000,000 in 33 years at 4%. Or taking operating expenses as $500,000 per year, enough to amortize over $11,400,000 on the same terms, i.e., $4,400,000 more than the plan proposes to amortize in 35 years at 4%.

The simple fact is, therefore, that it appears indisputably from the records of the district, that the landowners have demonstrated, by actually paying them, both ability and willingness to pay assessments sufficient, with the district's other income, to amortize a refunding bond

issue many millions greater than that here sought to be approved.

And this is true, as a matter of physical fact, (a) taking the entire history of the district, i.e., the entire 18 years of its existence; (b) taking the last seven years; (c) taking the last three years; and (d) taking the worst agricultural year in the last forty years, namely, 1932.

There is, to be sure, some evidence (dealing with the early years of the district) that at that time some undetermined amount of assessments was being paid with outside funds, i.e., with income not derived from operations in the district. Two comments are appropriate: (1) There is no evidence that this is true in any substantial degree in recent years; (2) we submit that it is irrelevant in any event for the following reason:

Its only relevance is, of course, on the question of the extent of the ability of the debtor to pay. But the debtor is the district. Its income, as already shown at length and in our briefs, is such that it is able to pay many millions more than it offers to pay. We submit that the ultimate source of some part of its income from assessments is irrelevant.

Moreover, the debt in question is in substance a capital debt; it is the purchase price for the hydro-electric plant and irrigation system of the district. This property, in legal effect, belongs to the landowners (see authorities in our Reply Brief, pp. 28-29), and, indeed, it is obvious that the existence of these improvements is a principal cause of the value of the lands in the district. These improvements were paid for with the bondholders' money, i.e., are the source of the debt here in question. We know of no rule of law, whether in bankruptcy or elsewhere, by virtue of which a debtor can say that he need not pay for property purchased unless he can pay for it out of the income which he receives therefrom.

It is proper to point out that disapproval of the plan here proposed would not mean that the district would then be helplessly confronted with the full amount of its debts. In the first place, as we believe is shown, those debts have been scaled down over $9,500,000 already, by the contract with the RFC. (See particularly the Brief for Appellants Florence Moore, et al, p. 20, et seq.) In the second place, it is, of course, simply not true that in determining whether a plan proposed by a debtor is fair, the Court should consider that there are only two alternatives, namely, either the plan proposed or nothing. On the contrary, the Court may suggest, or the litigant may later propose, a different plan. Obviously if it were true that the only alternatives were either the particular plan proposed or nothing, then every plan would have to be held fair, however unfair in fact, if it was found that the debtor could not pay its debts in full without undue distress. All this is made plain in Case v. Los Angeles Lumber Products Co., 308 U. S. 106.

In other words, the question here is not whether the debtor can pay its debts in full, but whether the offer to pay fifty-one cents on the dollar, with no interest whatever (as to any bondholders who object) after July 1, 1931, is a fair offer.

The market value of the privately owned lands in the district far exceeds the amount offered by the plan.

The question of the value of the lands in the district has already been discussed at some length. Briefly, the assessment roll of the district values the privately-owned lands, as of 1937-38, at $11,468,155 (R. 667). In 1930-31 the district's assessment rolls valued the lands at over $20,000,000 (R. 667). This was reduced over $1,000,000 in 1931-32 and was further reduced over $6,000,000 in 1932-33, for reasons that do not appear other than the commence-

ment of negotiations for scaling down the district's debts (R. 667). In this connection it is significant that improvements on the lands are not assessed at all (R. 425), although, of course, those improvements go with the lands in the event the lands are taken over for nonpayment of assessments. Improvements are ignored in assessment simply in order to apportion a fair share of the taxes to land allowed to lie idle.

In 1936-37 the county assessed the lands of the district at $21,829,003 (R. 719). In connection with its application to the RFC for the loan here involved, the district informed the RFC that the valuation of lands in the county's assessment (for 1933-34) average $30 per acre, and that that amount was about 30% of the market value of the lands (Ex. OO, p. 103). This stated in effect that the rural lands alone had a market value in excess of $17,000,000. Prices of agricultural products increased from 1934 to 1937 over 75% (R. 734).

The petitioner's witness Momberg testified that he was the manager of 58 ranches in the district containing a total of 3688 acres owned by California Lands, Inc.; that these ranches were scattered all over the district; that they raised substantially all the crops grown in the valley; that the quality of these lands represented an average of all lands in the district; that the lands managed by him were held for sale at an average price of $135 per acre; that this sales price was determined by determining what amount the lands could pay **from earnings** so as to pay interest on the sale price, and also pay all of their taxes (R. 473, 474, 489, 492, 494).

These figures give a total market value, at the time of trial, of the agricultural lands alone, in excess of $23,000,000.

We submit on this ground alone that the plan is unfair as a matter of law under the rule of *Case v. Los Angeles Lumber Products Co.,* 308 U. S. 106. The only other

evidence of market value is an estimate in the Benedict Report, made many years ago, in the depths of the depression (Ex. 35, p. 128); and, indeed, even that report, speaking of the agricultural lands alone, totally ignoring the five cities and towns in the district, and ignoring all improvements on the agricultural lands, put a bare-land value on the agricultural lands of over $10,500,000 (Ex. 35, p. 128).

Judge Denman. Put your young men to work and get it in the brief, what you think about the statement of the statutory outcome of this finding (of fairness) under this statute.

Is RFC a secured creditor?

Mr. Haynes. Concerning the RFC, I submit that the RFC is a secured creditor, and, if it is, there is no question but what it is in a different class from the rest of us because the statute says so.

Judge Denman. Let me suggest to you this possible viewpoint on that: Of course, the only question there is as to whether or not the consent or participation of the RFC was on this loan or in that peculiar status that is granted to it by the definition in 402, isn't it? If it is in that status, this loan to the district is not one of the credits to be considered at all. That is to say, the definition consigns the claim of the RFC to the bonds it holds outstanding, of the old bonds.

Now, I understand your position to be that there is a loan, a definite loan, from the RFC to the district, which is secured by these old bonds, and also by a fund. Now to maintain your thesis, and you may be right, you have got to say that they were consenting in fact to the new loan and not the old?

Mr. Haynes. Let us see if that is necessarily so.

Judge Denman. You can go right along, but you say, as I understand you, that your theory is an allocation of

the power income, which is security for the money loaned by the RFC, and you say that makes a secured claim, and therefore, it hasn't got the same position that the others have?

Mr. Haynes. Let me just say this, your Honor——

Judge Denman. Now, what I am saying is, is it the interpretation of the definition that the only way that a governmental agency lending money is a principal, is through these outstanding bonds?

Mr. Haynes. I believe the answer is this, if the Court please: The RFC cannot consent at all under the statute unless it is a creditor; and it can consent only in its character as a creditor. Its consent filed in the case, if it has any significance, is as a creditor by virtue of the old bonds which it says it holds. If it is a creditor in any sense by virtue of its holding of those bonds, then, inescapably, under the language of its contract with the district, it is a secured creditor. The original resolution authorizing the loan, dated November 14, 1934, says:

> "(i) Allocation of Power Revenues: Unless the Borrower shall provide for the allocation of funds and income derived from the sale of electrical power by the Borrower to the payment of the loan authorized by this Resolution in an amount and manner satisfactory to the Division Chief and Counsel." (Ex. OO, pp. 177-8.)

And the final refunding bond purchase contract (Ex. OO, p. 202) provides for the same allocation of power revenue to the maintenance of a reserve fund and to the ultimate payment of the refunding bonds (Ex. OO, pp. 208-210). This reserve fund now contains over $1,000,000 (R. 669).

The debt of the district to the RFC is now evidenced, not by the contractual documents, but by the old bonds. There is no doubt that this is true. As appellee insists, the contracts provide that the old bonds may be kept alive "for any purpose". Moreover, the RFC reserves the right

in the contractual documents to require the district to levy assessments to meet the old bonds held by it, the RFC (Ex. OO, p. 165). There is no doubt from these and other provisions (e.g. p. 164, paragraph (c)) that until the old bonds are exchanged for refunding bonds, **the RFC loan is evidenced by the old bonds**; and that loan is a secured loan and therefore in a different class from the objecting bondholders.

I should say in passing that the extent of the RFC's rights in the old bonds, full exercise of which might embarrass the district, cannot be availed of by the district as a threat, either to the objecting bondholders or to the Court, as an argument that the plan should be approved. This is squarely held in Case v. Los Angeles Lumber Products Co., 308 U. S. 106, 129-31.

Moreover, the district has the right to tender refunding bonds for the old bonds at any time.

Payment of interest to consenting bondholders and the RFC as making the plan unfair.

On the question of fairness I should like to add a word to what has been said concerning the fact that the old bondholders were paid 4% interest, to the total amount of some $168,000 (R. 368), on the amount offered by the plan, and the fact that the RFC has received 4% interest from the time of its disbursement, i.e., October 4, 1935 (R. 344), namely, a total of 16% so far. The objecting bondholders, on the other hand, have received no interest or payment of any kind since July 1, 1931; and the plan proposes that they shall not receive anything, except the principal amount offered by the plan.

As we have seen, the district has for years had ample funds with which to pay all delinquent interest to the objecting bondholders. Its refusal to do so was, under the California law as shown in our briefs, a wholly illegal act

unless the plan was already tentatively in effect. If it was tentatively in effect, then it has operated for over four years already to discriminate against and penalize the bondholders who presumed to question it.

Now, fairness, I suppose, is a question of fairness to all.

In this case the bondholders were told, "If you have the temerity to question our plan, you must forego any income on your money for such time as it takes to litigate." Moreover, the bondholders were told that "If you don't like this plan, and you wish to withdraw these bonds, it will cost you $9.18 per bond for expenses to date" (R. 587). For some reason, the district apparently later repaid that $9.18 itself, but that is what the bondholders were told when the plan was submitted to them (R. 587).

It seems to me that in an ultimate sense, the principle of unconstitutional conditions comes in here. There is a great body of law that in making contracts, the government is in a different position, because of its capacity for compulsion, from that of an ordinary citizen, who can make as hard a bargain as he likes within rather wide limits. Statutes are held void which impose unreasonable conditions upon the exercise of ordinary rights, starting with *Western Union v. Kansas,* 218 U. S. 1, and down to date. The bondholders here were confronted by an agency of the State of California and an agency of the Federal Government, which looked the bondholder in the eye and said, "Here is what we offer you. Now, what are you going to do about it?"

The penalty for questioning their proposal was loss of income for such time as it might take to litigate it, plus $9.18 per bond.

What does "parity" mean in the RFC contract?

One further point concerning the RFC, namely, its actual intent. They undoubtedly wanted to maintain "parity" with the non-consenting bondholders. The only question is, so far as intent goes, What did they mean by "parity"?

Now, this contract expressly subjects itself to the law of California. It was made long before the Ashton decision; and there is no reason that I know of to suppose that any modification of the statute was in contemplation. What did they mean when they said in effect, "We want to maintain 'parity' with the old bondholders"?

Well, there was quite a lot of law about it. In California, *Anglo-California Trust Company v. Oakland Railways,* which we cite, and in other states and in federal cases, there were many decisions on the question of what "parity" a bondholder consenting to a partially completed reorganization is entitled to. They held that he is entitled to parity; and they meant that in the distribution of any fund, the consenting bondholder may get the same share that he would have got if he had kept his old bonds, **up to the amount of the reduced debt.**

There is no reason to suppose that the RFC intended to do more than the law permitted it to do at that time, so far as anybody knew under any existing authority. The bond purchase contract does not intimate that it did. It is not a conditional loan in any sense.

Judge Mathews. Does it require that non-consenting bondholders be treated differently than the RFC?

Mr. Haynes. It does not require that they be, but it plainly contemplates that they will be, if some do not consent, as is shown by the passage now to be quoted, and others:

> "The RFC shall be under no obligation to purchase refunding bonds beyond the amount necessary in its

judgment for refunding the indebtedness owed to creditors of the borrower who join in the plan of refinancing" (Ex. OO, pp. 205-6).

Upon motion by the objecting bondholders, the RFC was, upon order of the Court below (R. 139), served with notice to appear at a hearing to determine whether or not it is a creditor affected by the proposed plan of composition (R. 140). The matter was continued once, the RFC not appearing on the date set (R. 141, 142), but the RFC never did appear in response to the notice (R. 145). (The provision of the statute pursuant to which this notice was given reads as follows:

> "No creditor shall be deemed to be affected by any plan of composition unless the same shall affect his interest materially, and in case any controversy shall arise as to whether any creditor or class of creditors shall or shall not be affected, the issue shall be determined by the judge, after hearing, upon notice to the parties interested.")

It is, we submit, significant on the question of actual desire and intent of the RFC, that it has taken no part or interest in this proceeding whatsoever, other than to supply the district with its consent to the plan.

All benefits received by the district, including the RFC contract, are held in trust for the bondholders, under California law.

If the district's debt was scaled down in substance at the time of the contract, the district, which holds all its assets in trust for the bondholders, was not at liberty to deny the benefit thereof to its remaining bondholders. A private corporation, to be sure, can buy its old bonds at any price, and re-issue them, and thus keep them alive. But the district has no such power. If this district got a benefit from the RFC, it got it in trust for the bondhold-

ers. If the district profited by some old bondholders surrendering their bonds for 50 cents on the dollar, that benefit was received in trust for the remaining bondholders.

Lack of good faith.

Now, Mr. Downey sought to depreciate our discussion of the district's lack of good faith. The statute requires the plan to be submitted to the Court in good faith. Counsel says that the matters we discuss are matters of bookkeeping. Most of them are. But it is a notorious fact that there is no better way known for misleading a reader, on the value and amount of assets and liabilities, than bookkeeping. Our briefs point out where (without any moral wrong-doing, I suppose, but in an excess of loyalty), the officers and agents of this district have submitted data to the Court which are, to say the least, very misleading as to the financial history and present condition of the district. Mr. Lucius Chase, of Los Angeles, was to argue that matter, but he is sick in bed.

Res judicata.

Concerning the question of *res judicata,* I submit that the question deserves serious consideration, and ask the Court to give it that consideration. It should be considered with some of the fundamental propositions that are well established in mind.

The first is this: Mr. Justice Mathews asked, quite naturally, Which are you going to overrule, the new case or the old case? The answer is that a question of law can be *res judicata,* as well as a question of fact. And this rule would be meaningless unless it applied in cases where the true law at the time of the second decision is different from what it was at the time of the previous decision, or is unknown. There is no need of invoking the proposition that a rule of law is settled between the parties, if the

existing law is the same. In a recent case, *Stoll v. Gottlieb,* 305 U. S. 165, the Supreme Court says in effect,

> "We don't know what the law is on this question, but in any event it is settled between these parties by the previous decision."

It said concerning the rule of law which had been adjudicated between the parties (p. 172):

> "We express no opinion as to whether the Bankruptcy Court did or did not have jurisdiction of the subject matter."

The principle that a rule of law may be *res judicata* assumes that the law is different now from what it was at the time of the earlier decision.

Judge Mathews. Or that it is now claimed to be different?

Mr. Haynes. Yes, your Honor.

Judge Mathews. Just as an issue of fact litigated in a former case is sought to be relitigated by someone who proposes to establish the contrary fact in the present one?

Mr. Haynes. I should have stated it that way, your Honor.

That leaves just one question here, namely, What was adjudicated in the previous case between these parties?

There has been a good deal of talk about the Court having no jurisdiction. Well, it had jurisdiction to decide whether it had jurisdiction, and did so. A considerable part of the law of this country is in opinions holding that the Court had or did not have jurisdiction. The *Ashton* case is an example. The Supreme Court has gone so far as to hold that a Court has jurisdiction to decide that it has jurisdiction, even though it has not, and that its decision to that effect is *res judicata,* even though wrong (*Stoll v. Gottlieb, supra*).

Now, the record in this case contains the decree of this Court granting our motion to dismiss for want of juris-

diction (R. 106). The order doesn't say what the ground of the decision was, but the most elementary rule of *res judicata* is, of course, that when you want to find out what was litigated, what matters were settled between the parties by an earlier decision, you look at the documents in the case. As the Supreme Court said in *Oklahoma v. Texas,* 256 U. S., page 70, at page 88:

> "What was involved and determined in the former suit is to be tested by an examination of the record and proceedings therein, including the pleadings, the evidence submitted, the respective contentions of the parties, and the findings and opinion of the court; there being no suggestion that this is a proper case for resorting to extrinsic evidence. Russell v. Place, 94 U. S. 606, 608, 24 L. ed. 214, 215; Last Chance Min. Co. v. Tyler Min. Co., 157 U. S. 683, 688, et seq., 39 L. ed. 859, 862, 15 Sup. Ct. Rep. 733, 18 Mor. Min. Rep. 205; Baker v. Cummings, 181 U. S. 117, 124-130, 45 L. ed. 776, 779-782, 21 Sup. Ct. Rep. 578; National Foundry & Pipe Works v. Oconto Water Supply Co., 183 U. S. 216, 234, 46 L. ed. 157, 169, 22 Sup. Ct. Rep. 111."

Now, the pleadings in the previous case between these parties consisted solely of a motion to dispense with the printing of the record and to dismiss the action for want of jurisdiction (Ex. OO, p. 333). One ground, and one only, was stated in support of that motion, namely, that the Supreme Court had, since the decision in the Court below, decided the *Ashton* case, holding that Congress is without power to enact laws on the subject of bankruptcies subjecting the bonds here involved to being scaled down compulsorily. Now, there is no question at all, obviously, that that is what this Court decided when it decided the case.

There cannot be any question about what was adjudicated in the *Ashton* case; the Court's language is too plain. The Court did not decide on any detail of the

earlier statute. It dealt with the question of power. It said:

> "Our special concern is with the existence of the power claimed—not merely the immediate outcome of what has already been attempted. * * *
>
> "The especial purpose of all bankruptcy legislation is to interfere with the relations between the parties concerned—to change, modify or impair the obligation of their contracts. The statute before us expresses this design in plain terms. It undertakes to extend the supposed power of the Federal Government incident to bankruptcy over any embarrassed district which may apply to the Court. * * *
>
> "Neither consent nor submission by the States can enlarge the powers of Congress; none can exist except those which are granted. *United States v. Butler,* decided January 6, 1936, 297 U. S. 1. The sovereignty of the State essential to its proper functioning under the Federal Constitution cannot be surrendered; it cannot be taken away by any form of legislation. See *United States v. Constantine,* 296 U. S. 287. * * *
>
> "* * * for a very long time this court has steadfastly adhered to the doctrine that the taxing power of Congress does not extend to the States or their political subdivisions. The same basic reasoning which leads to that conclusion, we think, requires like limitation upon the power which springs from the bankruptcy clause. *United States v. Butler, supra.*"

I submit that on no imaginable grounds could it be held that the decision in that case would have been different if the statute before it had been this statute and not that statute. The power claimed is identical in both cases, and, in fact, it is exercised in substantially the same manner.

Now, is there anything shocking about the doctrine of *res judicata?* I submit that the question does not arise, because the Supreme Court has answered it in laying down the rule. This controversy received the considera-

tion of the Supreme Court of the United States in the *Ashton* case, and again in the previous case between these parties. The Court decided that there wasn't any such crying public need for the relief here sought to make it necessary to uphold this legislation.

The Court, as presently constituted, holds otherwise; but the only ground upon which it could rationally be argued that this case should be ruled out of the doctrine of *res judicata* would be that the results are too appalling; and I submit that in view of the earlier decision of the Supreme Court, that would be difficult.

Judge Denman. The Supreme Court, in a sense, is a super-legislative body, which, when it decides a thing one time, makes the law valid as to that, and when it overrules itself and decides another way, it makes the law as to that, and that is a legislative function, and your viewpoint would be the opposite of that?

Mr. Haynes. I don't see why.

Judge Denman. After all, can't something be said for that viewpoint? The Chief Justice, during his teaching period, had some views that seemed to suggest that, but in this later decision the tribunal adjudicated something that could not have been adjudicated before, and that something is the controversy over the validity of the plant, and its value, rather than where it is going to be tried out. I am just quoting.

Mr. Haynes. I don't follow your Honor at all.

Judge Denman. Your argument does not permit that line of contemplation?

Mr. Haynes. I didn't understand, your Honor.

Judge Denman. What you have here is a statement that the opinion of the Supreme Court is that we now have a tribunal open for this class of controversy; suppose the Legislature had done the same thing?

Mr. Haynes. In so far as Courts may be said to legislate, the doctrine that rules of law become *res judicata*

says that the later enactment does not apply as between parties who have already litigated the question.

Judge Denman. I am wondering if it is *res judicata.* It was decided at a time when there was no tribunal to hear the case, and it is adjudicated now at a time there is one, even though one would be overruling the other.

Mr. Haynes. What was adjudicated in the first case was not merely whether a tribunal existed which could grant the relief here sought, but whether the Constitution of the United States granted power to Congress to create such a tribunal.

There are cases which are more striking than this one. Mr. Clark is going to refer to the case of Stone against the Farmers Bank, in 174 U. S. 409. In that case a corporation had a charter, as we have a bond, exempting it, or it contended that it did, from taxation, a contract from the state not to tax it for ordinary property taxes. Two or three local taxing bodies, cities and counties, attempted to, and the bank sought an injunction and got it, and it was affirmed in the Supreme Court of Kentucky, which held that the contract was within the scope of the impairment of contracts clause in the Federal Constitution.

The taxing people persisted. A new taxing statute was passed, and new levies were made, years later.

Now, may I pause here a moment to say that there is no question but that the levying of taxes is a legislative act, and a new levy creates a new cause of action.

Very well; a new levy was made under the new statute, and the matter was again dragged through the Courts, and this time the bank sought to enjoin some of those with whom it had litigated the matter before, and some others in addition. The Supreme Court of Kentucky said in effect, "We disagree with our previous decision and hold that this charter is within the power of the state to amend its contracts under the police power." The Supreme Court of the United States agreed with the latter case on appeal to it by the bank. It held, however, that

as to the cities and counties which were parties to the first suit this charter was within the impairment of obligations or contracts clause, and that as to those who were not parties to the previous suit, the judgment of the Supreme Court of the United States prevailed, namely, that the charter was not, and never had been, within the scope of the impairment of obligations of contracts clause.

Judge Denman. But there is no question of tribunals in which the controversies are between the parties?

It is not a case involving a jurisdictional tribunal in which the contracts are to be settled. That was whether or not there was a change in the contract.

Mr. Haynes. Yes, your Honor.

Judge Denman. But I don't regard litigation in bankruptcy as a part of the body of law which enters into the contract and which cannot be changed. I don't see the district and its bond having incorporated into it the then existing law regarding bankruptcy, or any future existing law regarding bankruptcy.

Mr. Haynes. I don't think so, either.

Judge Denman. I don't see any impairment of the obligation of contracts by saying that I cannot see the analogy between your other case, which had to do with the merits of a controversy as to whether or not there had been an impairment of the obligation of contracts, and this case, which has to do with whether or not a tribunal exists to try another kind of controversy.

Mr. Haynes. In both cases this is true, is it not, your Honor, as in countless other cases involving different kinds of rules of law: a rule of constitutional law was laid down which the Court applied in the second case.

Judge Denman. Upon the merits that was decided upon, whether or not there had been an impairment of the obligation of contracts. In the second one they said, "The merits of that controversy having been decided as a matter of law, it will prevail here." We never got to the merits in this case.

It was held that the tribunal had the power the second time. That is what I am thinking at the present moment.

Mr. Haynes. It seems to me that nothing more fundamental, more meritorious, more on the merits, could be imagined than a decision of the Supreme Court of the United States that these bondholders could invoke the protection of the sovereignty of the states against an attempted exercise by the Federal Government of the power of bankruptcy, or, stated in another way, nothing could be more fundamental than a decision as to the division of powers between State and Nation effected by the Constitution of the United States. It was an epochal decision that the bankruptcy power does not include such contracts. The doctrine of *res judicata* is, that if a rule of law is laid down in an action between the parties, which, if applied in a later suit between them controls the result, then the second action is controlled by the first. I don't believe that any amount of talk about jurisdiction or no jurisdiction can affect the proposition that the rule of law laid down in the first case between these parties was a rule of law which, applied here, concludes it, and the rule of *res judicata* says just that.

Judge Mathews. The determination of a jurisdictional question often involves a determination of fact and often involves a determination of law, or both, and your argument is that such determination is conclusive on the parties in later litigation, regardless of whether the determination was made in connection with a jurisdictional question of some other kind of a question?

Mr. Haynes. Precisely, your Honor.

Judge Mathews. Provided that that determination was a necessary thing?

Mr. Haynes. Yes, your Honor.

Judge Denman. The cases you have spoken of here involving jurisdiction were cases where jurisdiction had been held to exist and the merits have been gone into? I am speaking now of the cases you mentioned; I have

not read the citations you have given. Have you a case that is exactly like this anywhere?

Mr. Haynes. I don't recall one, your Honor. The only doubt has been just the other way around. Up until quite recently, up until the case of *Stoll v. Gottlieb* (supra), there had been a considerable amount of opinion in support of the proposition that if the Court did not have jurisdiction and decided that it did, its judgment was void. But the Supreme Court now says that is not true.

Now, there has never been any question, so far as I know, of the jurisdiction of a Court which **had** jurisdiction to decide finally, even though erroneously, that it **did not have** jurisdiction.

Let us say that the next day after the decision in the *Ashton* case, the district involved in the *Ashton* case had filed another proceeding; wouldn't your Honor's argument call for the conclusion that the Court would have to entertain the new suit, and start all over again? I cannot see any escape from that.

May I presume to say this in closing: That never in my limited experience has a Court been so indulgent, so patient, and, if I may say so, so industriously interested in the case before it.

MEMORANDUM ON GENERAL FINDINGS OF FAIRNESS.

Pursuant to the direction of the Court at the oral argument, we filed this memorandum on the question whether a general finding of fairness is a sufficient finding of fact. The trial Court's finding on this question reads as follows:

> "That the plan of composition as offered by the petitioner herein is fair, equitable and for the best interests of its creditors and does not discriminate unfairly in favor of or against any creditor or creditors or class of creditors" (R. 214).

Numerous federal statutes, of course, require findings of fact in particular actions. Such statutes are discussed in the cases cited below.

Preliminarily, it is perhaps proper to state the fundamental rules on the subject. Findings of fact must be findings of ultimate facts, not of evidentiary or probative facts:

U. S. v. Esnault-Pelterie, 299 U. S. 201, 205.

On the other hand, the findings must be findings of fact, not conclusions of law:

U. S. v. Jefferson Electric Co., 291 U. S. 386, 408;
U. S. v. Esnault-Pelterie, 299 U. S. 201, 205;
Kahn v. Smelting Co., 102 U. S. 641, 647.

Findings by the Court were unknown to the common law. Their purpose, and the rules concerning them, are similar to those concerning special verdicts:

Anglo-American Land Co. v. Lombard, 132 Fed. 721, 733, and cases cited;
U. S. v. Sioux City Stock Yards Co., 167 Fed. 123, and cases cited;
St. Louis v. The Ferry Co., 78 U. S. 423, 428.

Their purpose is to enable the appellate courts to determine whether the trial Court properly applied the law to the facts of the case; and to enable the appellate court

to order the correct judgment, if the trial Court's view of the law was erroneous:

> *Anglo-American Land Co. v. Lombard,* 132 Fed. 721, 733, and cases cited.

The question, therefore, is whether or not the trial Court's finding simply that the plan is "fair," is a proper finding of ultimate fact or a mere conclusion of law.

There is, of course, no mechanical test whereby the answer to questions like this can be easily and infallibly determined. The question must be answered on the basis of the particular considerations present, as to each particular type of proposition concerning which the question arises. This is illustrated by the following quotation from Ruling Case Law:

> "Propositions which are in reality conclusions of law cannot be given effect as findings though included with the findings of fact. * * * Accordingly a finding that a mistake occurred through neglect of legal duty by a party, or that money was paid to a party as legatee, as well as a finding that a contract is contrary to public policy, or that a contract provision is reasonable, is merely a conclusion of law. Likewise where a finding that a defense is sustained is based specifically on a finding of fact it cannot be given effect as an independent finding of fact. On the other hand a finding as to the cost of an article, or that a party did not rescind a sale, or that parties were living together, or that the plaintiff is the owner of a right of way and that it is an appurtenance to land, is a finding of fact" (26 R. C. L. 1091-1092).

In the first place, it is unnecessary to argue the proposition that the question is not to be answered on the basis of some mechanical test, but must be decided on the basis of the substantial considerations involved. We believe that there are several substantial considerations that should be taken account of:

1. The question of substantive law presented is relatively new, and yet to be finally settled by the Court of last resort.

For that reason it appears that the trial Court should find the facts bearing on the question whether the plan is fair, so as to enable the Courts on appeal to know the legal basis upon which the trial Court reached its conclusion. This proposition is supported by the case of

U. S. v. Jefferson Electric Co., 291 U. S. 386.

That case was a suit to recover back sales taxes alleged to have been illegally collected, which were recoverable only if "such amount was not collected, directly or indirectly, from the purchaser or lessee, or that such amount, although collected from the purchaser or lessee, was returned to him". On this question, the trial Court found that plaintiff had "sustained the burden of proof"; and (after reciting certain circumstances) found in terms that although "the tax was collected from the purchasers" by plaintiff, it "was wholly returned to them".

The Supreme Court said in part (p. 408):

> "Saying that the plaintiff has sustained the burden of proof as to the designated issue in suit No. 3371 is not an adequate finding of the matters of fact involved in that issue, **particularly where, as here, the subject is new and may admit of differing opinions.** It is in the nature of a legal conclusion rather than a finding of the underlying facts, and we think it does not adequately respond to the issue and is not sufficient to support the judgment which rests on it."

And further, after disagreeing with the trial Court's conclusion (quoted above), said (p. 409):

> "* * * That conclusion must therefore be disregarded. It results that the finding, while showing that the plaintiff collected the tax from the purchasers, does not show whether it returned the tax to them. Thus the finding does not adequately respond to the issue arising on the plaintiff's allegation that

it absorbed the tax—for, having collected it from them, the plaintiff could absorb it only by returning it to them. With that matter left in this situation the finding plainly does not support the judgments which rest on it.

"As the judgments of the District Court in the three suits must be reversed because of insufficiencies in the special findings, and as the reversal by the Circuit Court of Appeals was put on an untenable ground, we deem it the better course to enter here a judgment reversing the judgments of both courts and remanding the suits to the District Court with a direction to vacate its findings and grant a new trial in each suit."

2. It is obvious that the question whether a particular plan is fair, involves several questions of law, which, indeed, are presented by the facts of this case. For example,

(a) Is a plan fair which offers much less than the income of the debtor district will enable it to pay, merely because in the past some of the landowners, and doubtless some still, are unable to pay all of their assessments out of net income derived from the land?

(b) Is a plan fair under which a taxing district offers an amount much less than the market value of the lands of the district charged with payment of its debts?

(c) Can a plan be held to be fair on the basis of evidence (we say insufficient evidence), that the agricultural income of the district would not justify payment of a greater amount, where, as a matter of fact, the landowners have, year by year, throughout the entire history of the district, actually paid in assessments an amount sufficient (together with the district's other income) to pay a much greater amount than that offered? These and similar questions of law as to what is "fair" (discussed in our briefs) are yet to be settled.

This being true, it is apparent that a finding simply, in the language of the statute, that a plan is "fair", makes it impossible for the Court on appeal to determine whether or not the case was correctly decided in the Court below.

The case of

Miller v. Gusta, 103 Cal. App. 32,

together with the cases cited in the opinion therein, illustrate and emphasize this proposition. In California, by statute, specific performance of a contract cannot be granted unless the contract is, as against defendant, fair and reasonable and supported by adequate consideration. Under this statute the Courts hold that a finding, merely in the language of the statute, will not support a judgment; since to hold that such a finding is sufficient would confer on the trial Courts unlimited power to follow their individual ideas concerning the legal meaning of the requirements of fairness. Thus, in *Miller v. Gusta, supra,* the Court said:

> "While it is undoubtedly true, as suggested by counsel, that operation through a receiver is ordinarily more costly and less profitable than the same operation would otherwise be, these figures are none the less startling. Even in the face of them, however, we would feel compelled to accept the finding of the trial court upon this conflicting evidence if that finding was sufficient. But, as suggested above, the finding is subject to the same vice as the pleading in that it follows the identical language of the complaint above set out. **In other words, the trial court instead of finding the facts from which the justness and reasonableness of the contract and the adequacy of the consideration would follow as a conclusion of law simply found 'that said contract is fair and equitable and that the consideration * * * is an adequate consideration.'** Under the authorities above quoted this is a **bald conclusion of law. It is impossible from this finding for this court to know on appeal what value the court put on any of the properties involved in the exchange. Nor can we even conjecture in view**

> of the sharp conflict in the testimony what values the trial court may have had in mind, or what sort of contract in the trial judge's opinion would be fair and equitable or what consideration adequate. The values might, if they had been found by the trial court, be so disproportionate as to lead this court to disagree with the trial court's conclusion as to the fairness of the contract and the adequacy of the consideration. As to that we are left in the dark."

So here, we submit, unless the trial Courts find the ultimate facts upon which they base the conclusion that a particular plan is fair or not fair, then the function of the appellate courts will be wholly frustrated, since they will be powerless to require the trial Courts to conform to the relevant rules of law concerning what is fair.

3. The opinion of the Supreme Court in

Case v. Los Angeles Lumber Products Co., 308 U. S. 106, 113-114, 119,

seems to leave no doubt that the question of fairness is a question of law to be determined from ultimate facts. In that case, indeed, the trial Court had found the plan fair; but the Supreme Court found no difficulty in reversing the decision on the ground that the plan was not fair.

If "fairness" is an ultimate fact, then the trial court may, and should, refuse to find the facts upon which its finding of fairness rests. If so, the reversal in the *Los Angeles Lumber Products* case was due to the purely accidental circumstance that the facts bearing on fairness appeared incidentally in the record.

Other cases decided under Section 77B point in the same direction. See

Tennessee Publishing Co. v. American Nat. Bank, 299 U. S. 18;

Central States Life Ins. Co. v. Koplar Co., 85 F(2d) 181;

Wayne United Gas Co. v. Owens-Illinois Glass Co., 91 F(2d) 827.

It is, we submit, clear that the finding of good faith (R. 214), is in the same category. See

John Hancock Mut. Life Ins. Co. v. Bartels, 84 L. Ed. (Adv. Ops.) 154.

4. The statute here involved requires (a) that the Court be satisfied that the plan is fair, and (b) that it make findings of fact. The latter provision is meaningless if the only finding of fact that need be made on the question of fairness is a bald statement that the plan is fair.

For the foregoing reasons and for the further reasons stated in our briefs, we submit that the question whether or not this plan is fair is at large; that the trial Court's finding upon the question is a mere conclusion of law. See particularly our Reply Brief, pages 33-34.

Respectfully submitted,

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